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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1971

No. 71-308

UNITED STATES OF AMERICA,

*Petitioner,*

*v.*

MARIAN A. BYRUM, Executrix Under the Last Will  
and Testament of MILLIKEN C. BYRUM, Deceased,  
*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SIXTH CIRCUIT

**BRIEF OF HOWARD GILMAN, CHARLES GILMAN, JR.  
AND SYLVIA P. GILMAN, EXECUTORS OF THE WILL  
OF CHARLES GILMAN, DECEASED, AS AMICI CURIAE**

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OF CHARLES GILMAN, DECEASED, AS AMICI CURIAE**

This brief in support of Respondent's position is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

**Interest of the Amici Curiae**

The *amici curiae* are the executors of the will of Charles Gilman (the "Decedent"), a New York resident who died in 1967. The Commissioner of Internal Revenue (the "Commissioner"), has proposed a deficiency of several million

dollars in the estate tax liability of the Decedent's estate by including in the gross estate the alleged value of the assets of an *inter vivos* trust (the "Trust") created by the Decedent in 1948. The Executors having protested the proposed deficiency, the Commissioner is preparing to issue a statutory notice of deficiency. The Executors intend, upon receipt of the notice, to petition the United States Tax Court for review of the deficiency.

The relevant facts with respect to the Trust as of the time of the Decedent's death may be briefly summarized. The Decedent had no beneficial interest in the Trust; his two adult sons were to receive the income for life and, upon the death of the survivor of them, the remainder was distributable to their issue. The Trust was irrevocable; moreover, it fixed beyond amendment the disposition of its income and corpus and the time of its termination. The Trustees (the Decedent and two other individuals) could act by majority vote. They were authorized to sell any assets of the Trust and to reinvest the proceeds, without being confined to investments of the kind prescribed by law. The Trust assets consisted of six shares of common stock of Gilman Paper Company (the "Company"), a New Hampshire corporation, which were the only outstanding shares of that class and the only voting shares. The Company also had outstanding 5,262 shares of nonvoting participating preferred stock, of which 5,000 were owned by the Decedent. The Decedent was President and one of the three directors of the Company.

The Commissioner asserts that the stock of the Company held by the Trust is includible in the Decedent's gross estate solely because the Decedent, as one of the three Trustees, could participate in the voting of that stock.

### Summary of Argument

Reserved managerial and administrative powers over property transferred in trust during life, including power to vote trustee stock, do not subject the transferred property to estate tax. That rule is established by 28 decisions of this Court and the lower courts spanning a period of over 40 years; no court holds to the contrary. These decisions uniformly distinguish managerial and administrative powers over transferred property from the power "to designate the persons who shall possess or enjoy the property or the income therefrom" embraced by section 2036(a)(2) of the Internal Revenue Code. These decisions apply irrespective of whether the deceased settlor reserved the power as trustee or in his individual capacity.

The principles of those decisions apply to the transfer by a controlling stockholder of shares of his stock in trust with reservation of power to vote the trustee shares and to prevent their sale.

The Government's argument that estate tax liability is created by the decedent's alleged power to make the trustee stock dividend-paying or non-dividend-paying proves too much. By the same token, all of the 28 decisions we have mentioned were wrongly decided, since each settlor could have designated who should enjoy income by arbitrarily investing in income-producing or non-income-producing stocks or other property.

The decedent's control over the corporations involved did not give him a power over enjoyment of the trustee property or income within the meaning of section 2036(a)(2), for a controlling stockholder or a director is a fiduciary. While directors possess a range of business discretion in setting dividends, courts will intervene if dividend policy is dictated by non-corporate considerations. As a corporate fiduciary, the decedent's discretion was subject to

external standards enforceable in a court of equity, so that his powers were no greater than the managerial or administrative powers that a settlor-trustee may reserve without incurring estate taxation.

The decedent's right, exercisable through the board of directors, to maintain himself in corporate employment and to be compensated therefor was not a reservation of enjoyment of the stock transferred in trust. As the Tax Court has held, the right or opportunity to draw a reasonable salary from a corporation does not amount to retained enjoyment of transferred stock within the meaning of section 2036(a)(1) of the Internal Revenue Code. A reasonable salary is earned; its *quid pro quo* is the services rendered.

The standards of fiduciary obligation that circumscribe corporate dividend policies also circumscribe corporate salary policies. A controlling stockholder may not vote himself, or cause himself to be voted, an excessive salary. The enjoyment of a minority stock interest in a corporation is the prerogative of its owner, and may not legally be usurped by the controlling stockholder through abuse of corporate office.

The income tax decision of *Commissioner v. Sunnen*, 333 U.S. 591 (1948), on which the Government relies, is legally inapposite to the estate tax. Decisions of this Court and the lower courts clearly establish the lack of correlation between the income and estate taxes in the field of incomplete transfers. *Sunnen* is also factually irrelevant, since the taxpayer in that case retained important controls unrelated to his status as controlling stockholder.

This case calls for application of the doctrine of *stare decisis*. The principle the Government here seeks to overturn was established in a 1929 decision of this Court, *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929), which the Government has not satisfactorily distinguished. The

erosion of that principle sought by the Government here would open to taxation an indeterminate—perhaps broad—category of trusts long regarded as nontaxable. If the Government is discontented with the present long-established rule, it should address itself to the Congress. It should not succeed in its request to this Court for retroactive reversal in disregard of *stare decisis* at this late date.

## ARGUMENT

### I.

**Reserved managerial or administrative powers over property transferred in trust during life, including power to vote trustee stock, do not subject the transferred property to estate tax.**

The Federal estate tax statute has, from the date of its original enactment in 1916, attempted to forestall tax avoidance by including in the measure of the gross estate certain incomplete lifetime transfers of property that are regarded as substitutes for testamentary dispositions. For 55 years interpretation of the incomplete lifetime transfer provisions has vexed the administrators and the courts. However, within the kaleidoscopic pattern of the court decisions, on one proposition there is accord: Reserved managerial or administrative powers over property transferred in trust during life, including power to vote trustee stock, do not subject the transferred property to estate tax.

**a. This rule is established by a long line of decisions of this Court and the lower courts.**

The story begins with *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929), in which one question was whether the assets of five *inter vivos* trusts should be included in the

gross estate of the deceased settlor, who was not a trustee, because of his reservation in his individual capacity of powers "to supervise the reinvestment of trust funds, to require the trustee to execute proxies to his nominee, to vote any shares of stock held by the trustee, to control all leases executed by the trustee, and to appoint successor trustees," 278 U.S. at 344. Holding that the five trusts were not subject to estate tax, this Court said:

"Nor did the reserved powers of management of the trusts save to decedent any control over the economic benefits or the enjoyment of the property. He would equally have reserved all these powers and others had he made himself the trustee, but the transfer would not for that reason have been incomplete. The shifting of the economic interest in the trust property which was the subject of the tax was thus complete as soon as the trust was made. . . . [T]he reserved powers do not serve to distinguish [the trusts] from any other gift *inter vivos* not subject to the tax." *Id.* at 346-347.

In 1931 and again in 1933 this Court adhered to the above-described holding.<sup>1</sup> Still later, in 1948, this Court *sua sponte* invited reargument of the question. *Commissioner v. Estate of Church*, 335 U.S. 632 (1949); *Estate of Spiegel v. Commissioner*, 335 U.S. 701 (1949). The decedent in each of those two cases had made a lifetime transfer of property to himself and another person or persons as trustees and had conferred on the trustees broad managerial and ad-

1. (1) *McCormick v. Burnet*, 283 U.S. 784 (1931), a *per curiam* reversal of a decision of the Seventh Circuit that had found support for taxability of an *inter vivos* trust in the deceased settlor's reservation of power to make investment decisions. 43 F.2d at 280.

(2) *Helvering v. Duke*, 290 U.S. 591 (1933), a *per curiam* affirmation by an equally divided Court of a Third Circuit decision for the taxpayer, in which this Court received extensive argument from the Government, that the trust was taxable because the deceased settlor had retained managerial powers as trustee.

ministrative powers; moreover, the decedent in *Church* had reserved in his individual capacity the power to control investment of the trust assets. 335 U.S. at 691-692, note 1; 736. After argument and consideration of the two cases at the October 1947 Term, this Court entered an order restoring them to the docket and requesting counsel upon reargument to discuss particularly nine questions, including the following:

"6. Under section 811(c) [of the Internal Revenue Code of 1939, the predecessor of section 2036 of the Internal Revenue Code of 1954] is the 'possession and enjoyment' of the corpus of an *inter vivos* trust 'intended to take effect \* \* \* at or after' the settlor's death, where he names himself as co-trustee with the broad control and administrative powers over the corpus and income here vested, and where the corpus is withheld from the beneficiaries until the settlor's death?" Journal Supreme Court, Oct. Term, 1947, pp. 297-298; 335 U.S. at 717, note 5.<sup>2</sup>

In its *Church* and *Spiegel* decisions, this Court answered the above question negatively by not overruling or modifying its *Northern Trust* holding with respect to reserved managerial powers.

Understandably, therefore, every lower court that has considered the estate tax classification of managerial or administrative powers in recent years holds them not to be classifiable with the taxable powers over beneficial enjoyment described in section 2036(a)(2) of the Internal

2. The Government responded in its brief on reargument by conceding that the *Northern Trust* case had rejected as immaterial the settlor's reserved powers of management and by stating: "While we hesitate to suggest that the *Northern Trust* case should be disapproved on this ground alone, we think that this ground, coupled with the general basic considerations discussed above [*i.e.*, that the decedent's life measured the duration of the trust and that there was a remote possibility that the property would revert to him] may appropriately call for reexamination of that case." Gov't brief on reargument, pp. 43-44.

Revenue Code. Particularly noteworthy is *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970), in which the First Circuit expressly rejected the Government's argument that the settlor-trustee's broad administrative and management powers were a ground for estate taxation and, in doing so, expressly repudiated its much-criticized decision in *State Street Trust Co. v. United States*, 263 F.2d 635 (1st Cir. 1959). The First Circuit said in *Old Colony*: "We hold that no aggregation of purely administrative powers can meet the government's amorphous test of 'sufficient dominion and control' so as to be equated with ownership." 423 F.2d at 603.

Four other Circuits, a District Court and the Tax Court concur in this view: (1) The Second and Third Circuits in *per curiam* affirmances of Tax Court decisions;<sup>3</sup> the Sixth Circuit in the decision below; the Tenth Circuit in *United States v. Powell*, 307 F.2d 821 (10th Cir. 1962), in which the court said "We conclude the investment power given to the trustees [the deceased settlor and a trust company] by the trust instrument was subject to and limited by a judicially established and judicially enforceable external and ascertainable standard and, hence, was no more than a management or administrative power" (307 F.2d at 826); the District Court for the Northern District of Illinois in *Yeazel v. Coyle*, 68-1 U.S.T.C. ¶12,524 (N.D. Ill. 1968), involving a deceased president and sole shareholder of a corporation who had transferred approximately 60 percent of the stock to herself as trustee, retaining the remaining 40 percent; and the Tax Court in an unbroken series of 19 decisions.<sup>4</sup>

3. *Estate of Ford v. Commissioner*, 450 F.2d 878 (2d Cir. 1971), *aff'g per curiam* 53 T.C. 114 (1969); *Commissioner v. Wilson's Estate*, 187 F.2d 145 (3d Cir. 1951), *aff'g per curiam* 13 T.C. 869 (1949).

4. The two decisions cited in note 3, *supra*, and the following: *Estate of Ralph Budd*, 49 T.C. 468 (1968); *Estate of Marvin L. Pardee*, 49 T.C. 140 (1967); *Estate of James H. Graham*, 46 T.C. 415 (1966); *Estate of Willard V. King*, 37 T.C. 973 (1962); *Estate*

In the most fully-reasoned of the 19 Tax Court decisions, *Estate of Willard V. King*, the trust indenture made by the decedent provided that trust principal might be invested in any type of property, even though speculative, extrahazardous or unproductive, and that the trustee should exercise the rights of management and investment only in accordance with the decedent's directions. The Tax Court concluded as follows:

"[W]e think that although the decedent, under his broad discretionary powers with respect to investment, might invest in properties producing either a high or a low return of income, such powers would have to be exercised in good faith in accordance with his fiduciary responsibility and could not be used for the purpose of attempting to favor any beneficiary or class of beneficiaries to the detriment of the other beneficiaries. It is our conclusion that the right retained by the grantor was not the right to designate the persons who should possess or enjoy the property or the income therefrom within the intendment of Section 2036(a)(2)." 37 T.C. at 980.

Analysis of the 28 decisions cited and discussed above demonstrates the breadth and vitality of the principle the Government here seeks to overthrow. The decisions are by eight courts, spanning a period of 42 years, and no court holds to the contrary. The trusts in these cases involved

of *George W. Hall*, 6 T.C. 933 (1946); *Estate of William F. Hoford*, 4 T.C. 790 (1945), modifying 4 T.C. 542; *Estate of Henry S. Downe*, 2 T.C. 967 (1943); *Lillian M. Wheeler*, 20 B.T.A. 695 (1930); *Estate of Aline Peters Peters*, T.C. Memo 1964-67; *Estate of Pierre Jay Wurts*, T.C. Memo 1960-102; *Estate of Benjamin Paschal O'Neal*, 6 CCH T.C.M. 713 (1947); *Estate of George F. Fiske*, 5 CCH T.C.M. 42 (1946); *Estate of Bayard Dominick*, 4 CCH T.C.M. 226 (1945) (supplemental opinion), *aff'd as to other issues*, 152 F.2d 843 (2d Cir. 1946); *Estate of Maurice Markson*, 3 CCH T.C.M. 309 (1944); *Estate of Laura B. Alexander*, 2 CCH T.C.M. 1156 (1943); *Estate of B. H. Kroger*, 2 CCH T.C.M. 644 (1943), *aff'd as to other issues*, 145 F.2d 901 (6th Cir. 1944); *Estate of Herbert L. Johnston*, 2 CCH T.C.M. 299 (1943).

varied types of property, including marketable securities, real estate and stocks of closely-held corporations. In all of the 28 cases the deceased settlor had broad investment powers over the trust property. The decedent held the investment powers in 8 of the cases as sole trustee<sup>5</sup> and in 6 of the cases as cotrustee with another person or persons.<sup>6</sup> In the remaining 14 cases the decedent was not a trustee, but had reserved in his individual capacity the right to make the investment decisions for the trust.<sup>7</sup> In 20 of the 28 cases the decedent had the right, alone or in conjunction with another person, to vote any stocks held by the trust.<sup>8</sup>

We have dealt at considerable length with this uniform and massive body of decisions because of the Government's attempt to dispose of the *Northern Trust* holding with respect to managerial powers on the ground that the case antedated the 1931-32 recasting of what is now section 2036 of the Internal Revenue Code.<sup>9</sup> Pet. Br. 18-19. That holding has received too much post-1932 reaffirmance and support to be vulnerable to the Government's charge.

5. *Duke, Ford, Yeazel, Pardee, Wheeler, Peters, Fiske* (there was a cotrustee, but the settlor's decisions were to prevail in the event of disagreement) and *Markson*.

6. *Spiegel, Old Colony, Powell, Budd* (as to one trust; as to the other trust the settlor reserved the power to remove and replace the trustee), *Graham* and *Hofford*.

7. *Northern Trust, McCormick, Church* (who, although a cotrustee, reserved the investment powers in his individual capacity), *Wilson, King, Hall, Downe, Wurts, O'Neal, Dominick, Alexander, Kroger, Johnston* and the case below (hereinafter *Byrum*).

8. Cases cited in notes 5 and 6, *supra*, and *Northern Trust, McCormick, Church, Byrum, King* and *Downe*.

9. The Government also says that *Northern Trust* arose before the 1924 enactment of the predecessor of the present section 2038. The Government's statement is irrelevant, since it is not relying on section 2038 in seeking reversal of the decision below. Moreover, its statement is inaccurate, since the 1924 enactment was made five years before the *Northern Trust* decision and was expressly made retroactive. Revenue Act of 1924, section 302(d) and (h).

**b. The rule developed in the court decisions applies in the instant case.**

The Government, while acknowledging the existence of the general rule requiring impartiality in the exercise of managerial powers by a fiduciary, argues that the rule does not apply to trusts of closely-held stock where, as here, the deceased settlor was the controlling stockholder and could prevent sale of the trustee stock. Pet. Br. 15-16, 19-20. The Government urges that such a settlor could, being unconfined by fiduciary restraints, exercise control of dividend policy through the board of directors and thus regulate the flow of income to the trust. Pet. Br. 14-15, 19.

The Government's argument that the trust is embraced by section 2036(a)(2) because of the decedent's alleged power to make the trustee stock dividend-paying or non-dividend-paying (Pet. Br. 15-16, 19-20) proves too much. Under that argument, the trust in each of the other 27 estate tax cases we have cited (pp. 5-10; *supra*) was taxable because the settlor could have invested, or directed the trustee to invest, the trust corpus in dividend-paying stocks or in non-dividend-paying stocks or in other income-producing or non-income producing property. The Government's analysis obviously cannot be squared with *Northern Trust* and its numerous progeny, the teaching of which clearly is that the power to vary the flow of income through managerial or administrative decisions is just not the type of power reached by section 2036(a)(2). In arguing that the rule of law developed in the cases involving individually retained investment powers over security portfolios does not control here, the Government is creating a semantic distinction without a real difference.

The Government also asserts that, the decedent not being a trustee, the general rule requiring impartiality has no application. Pet. Br. 19. However, as we have shown

(note 7, *supra*, and accompanying text), *Byrum* is one of 14 estate tax cases, including this Court's landmark *Northern Trust* case, in which the settlor of an *inter vivos* trust retained management powers in his individual capacity, including the power to direct the trust's investment policy. Each of the other 13 settlors, like the decedent, could veto sales of trust property. In all 14 cases the courts held that the decedent had not retained a tax-producing power. As the Tax Court said in *King*, *supra*, the creator of a trust who names another as trustee and reserves in his individual capacity the right to direct the trustee's exercise of investment and voting powers has "in effect made himself a fiduciary" and is "not at liberty to administer the trust for his own benefit or to ignore the rights of the beneficiaries." 37 T.C. at 980. Under this line of decisions, retained management powers are not made tax-producing by the fact that they are retained otherwise than in the office of trustee.

We now turn to the principal vice of the Government's argument—its assertion that controlling stockholders and directors are not confined by fiduciary obligations. Pet. Br. 14-20. As this Court said in *Pepper v. Litton*, 308 U. S. 295, 306 (1939), "A director is a fiduciary. . . . So is a dominant or controlling stockholder or group of stockholders. . . . Their powers are powers in trust." The same principle has been stated often, for example, in *Kullgren v. Navy Gas & Supply Co.*, 110 Colo. 454, 135 P. 2d 1007, 1010 (S. Ct. 1943), "The relation which directors bear to the stockholders of a corporation, and the corporation itself, as 'universally conceded . . . is a fiduciary one;' and 'The law governing the obligations of fiduciaries is applicable to them.'"

These are basic principles of corporate common law, not turning on the construction of a particular corporate

statute<sup>10</sup> nor dependent on the presence of public security holders. O'Neal, the leading commentator on the law of closely-held corporations, in his treatise *Close Corporations* (1958 ed.) summarizes the applicable law as follows:

"As was said by the Court of Appeals of New York [*Kavanaugh v. Kavanaugh Knitting Co.*, 226 N.Y. 185, 123 N.E. 148 (1919) at pp. 151-152], whenever a number of stockholders 'constitute themselves, or are by the law constituted, the managers of corporate affairs or interests, they stand in much the same attitude toward the other or minority stockholders that the directors sustain generally toward all the stockholders, and the law requires of them the utmost good faith', and a court of equity 'will protect a minority stockholder against the acts or threatened acts of the board of directors or managing stockholders of the corporation which violate the fiduciary relation and are directly injurious to the stockholders'. And, as a federal court has said, [*Jones v. Missouri-Edison Elec. Co.*, 144 Fed. 765, 771 (8th Cir. 1906)], majority shareholders 'owe to the minority the duty to exercise good faith, care and diligence to make the property of the corporation in their charge produce the largest possible amount, to protect the interests of the holders of the minority of the stock and to secure and deliver to them their just proportion of the income and of the proceeds of the property.'"

§ 8.07, at pp. 45-46.

There is no doubt that corporate directors possess a wide range of business discretion in setting dividends and that courts are consistently and properly reluctant to sub-

10. The law of Ohio is, however, consistent: see *Selama-Dindings Plantations, Ltd. v. Durham*, 216 F. Supp. 104 (S. D. Ohio 1963), *aff'd*, 337 F.2d 949 (6th Cir. 1964); *State v. Witmore*, 126 Ohio St. 381, 185 N.E. 547 (S. Ct. 1933); *Thomas v. Matthews*, 94 Ohio St. 32, 113 N.E. 669 (S. Ct. 1916).

stitute their business judgment for that of the directors.<sup>11</sup> There is no doubt either, however, that it is business judgment only that is deferred to and that a dividend policy stemming from non-corporate considerations, for example, a desire to postpone current income in favor of trust remaindermen, lacks the business basis which can alone justify it, and provides an occasion for judicial intervention at the behest of minority shareholders. The same would be true of an excessive dividend policy motivated by the desire to prefer income beneficiaries at the expense of remaindermen.

Fletcher summarizes the rule as follows: "However, the directors are not a law unto themselves, and there is some limit to their right to husband the finances of the company and reinvest the profits, or to put them back into betterments and improvements of the company's plant. The discretion of the board of directors in this regard is not unlimited, and it must be honestly exercised for the benefit of the corporation and all its shareholders." Fletcher, *Cyclopedia Corporations* (perm. ed. 1971) § 5325 at p. 633. "The principle to be applied is that which shall secure the observance of good faith on the part of the directors. . . ." *McNab v. McNab & Harlin Mfg. Co.*, 62 Hun 18, 16 N.Y.S. 448, 449 (S. Ct. 1st Dept. 1891), *aff'd*, 133 N.Y. 687, 31 N.E. 627 (Ct. App. 1892). "The essential test of bad faith is to determine whether the policy of the directors is dictated by their personal interests rather than the corporate welfare." *Gottfried v. Gottfried*, 73 N.Y.S. 2d 692, 695 (S.Ct. N.Y. Co. 1947).

11. *Nauss v. Nauss Bros. Co.*, 195 App. Div. 318, 187 N.Y.S. 158 (App. Div. 1st Dept. 1921); *In re Barrows' Will*, 123 N.Y.S. 2d 501 (Surr. Ct. Monroe Co. 1953); *City Bank Farmers Trust Co. v. Hewitt Realty Co.*, 257 N.Y. 62, 117 N. E. 309 (Ct. App. 1931); Ballantine, *Corporations* § 231 (rev. ed. 1946).

When the requisite business justification is absent and bad faith is present, the courts have been resolute in the remedies which they will impose. These include injunctive relief compelling the declaration of a dividend in a reasonable amount, and a retention of jurisdiction to assure that reasonable dividends will be paid in following years. *Patton v. Nicholas*, 154 Tex. 385, 279 S.W. 2d 848 (S. Ct. 1955) (decree to declare dividend at earliest practical date and thereafter to declare reasonable dividends annually from future profits and accumulated surplus); *Lesnik v. Public Industrials Corp.*, 144 F.2d 968 (2d Cir. 1944) (question for jury whether directors' failure to declare dividends was pursuant to a conspiracy to acquire a shareholder's stock); *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N.W. 668 (S. Ct. 1919) (directors ordered to distribute substantial additional dividends when reason for non-declaration was non-business purpose of providing more cars at lower price to benefit public).

What the Government argues is that the board of directors could, under applicable corporate law, improperly set dividends for the purpose of shifting income among trust beneficiaries and then build a record through minutes and otherwise of the spurious exercise of business judgment. The circumstances envisaged by the Government are the circumstances which, because they are pregnant with abuse, have induced courts of equity to apply standards of good faith and business reasonableness. What the Government describes is not a rule of law, but what one who embarks upon a campaign of fraud and bad faith, whether he be trustee or corporate fiduciary, may seek to get away with. Such is not the test of whether objective fiduciary restraints exist.

In summary, under applicable principles of corporate law, the discretion of the decedent was subject to judicial

scrutiny at the behest of affected shareholders; its range of permissible exercise was circumscribed by standards of fiduciary obligation that controlled his ability to shape dividend policy; and pursuit of a dividend policy motivated by non-business considerations would have violated such standards. As a corporate fiduciary, the decedent's discretion was subject to ascertainable external standards enforceable against him in a court of equity, so that his powers were no greater than the administrative or managerial powers that a settlor-trustee may reserve without incurring estate taxation.

## II.

### **The decedent did not reserve the enjoyment of the transferred stock.**

The Government makes the alternative argument that the decedent's right, exercisable through the board of directors, to maintain himself in corporate employment and to be compensated therefor constitutes a reservation of enjoyment of the stock transferred in trust. Pet. Br. 21-25.

The Government's argument has been rejected by the courts, not only in the decision below, but also in *Yeazel, supra*, in *Hofford, supra*, and in other Tax Court decisions hereinafter cited. No court has sustained it.

In *Hofford* a sole stockholder, immediately after entering into a contract with his corporation for a fixed salary for life, transferred the complete stock ownership to himself and others as trustees, reserving in his individual capacity the right to veto sale of the trustee stock. The Tax Court held, after intensive analysis of the facts upon the taxpayer's motion for reconsideration, that the decedent had not reserved enjoyment of the stock and, therefore, that

the stock was not includible in his gross estate under what is now section 2036.<sup>12</sup> This holding is supported by two similar Tax Court decisions involving outright transfers of stock by the sole or dominant shareholder immediately after entry into a contract with the corporation for a lifetime salary. *Estate of William L. Belknap*, 10 CCH T.C.M. 769 (1951); *George C. Doerschuck*, 17 B.T.A. 1123 (1929).

These decisions are clearly correct in holding that the right or opportunity to draw a reasonable salary from a corporation does not amount to retained enjoyment of transferred stock in the corporation. A reasonable salary is earned; its *quid pro quo* is the services rendered.

The standards of fiduciary obligation that circumscribe corporate dividend policies (pp. 12-15, *supra*) also circumscribe corporate salary policies and bar the controlling shareholder from treating the corporate entity as his personal convenience. A dominant shareholder is not permitted to take advantage of his stock ownership to vote himself an excessive salary or to cause an excessive salary to be voted to him by the directors elected by him. This Court clearly recognized that principle in *Rogers v. Hill*, 289 U.S. 582 (1933).

The leading commentators summarize the rule as follows:

"[D]irectors must act honestly and reasonably in setting the compensation of officers and executives

12. In the *Hofford* case the Tax Court distinguished and narrowly limited its earlier decision in *Ramelia D. Holland*, 47 B.T.A. 807 (1942), *reconsidered*, 1 T.C. 564 (1943). In the *Holland* case the decedent had retained, under an alleged contract of "sale" of the entire outstanding stock of the corporation by her and her husband to their children, an annual "salary" representing a return of approximately 20 percent of the value of the corporation's capital surplus and equalling about three and one-half times its average earnings, and caused the performance of the undertaking to be secured by the stock and by retention of all voting rights. The Government relies on *Holland* (Pet. Br. 22-23) while conveniently overlooking its having been limited by the Tax Court (4 T.C. at 794) to its peculiar facts.

... [I]n fixing compensation they will not be permitted to waste the corporation's assets ... [C]ompensation must bear some reasonable relation not only to the value of the services rendered but also to the ability of the corporation to pay ... [C]ourts of equity will review the fairness and reasonableness of compensation." O'Neal and Derwin, *Expulsion or Oppression of Business Associates: "Squeeze Outs" in Small Enterprises* (1961), at 56-57. See also O'Neal, *supra*, at § 8.12.

"Stockholders or directors cannot take advantage of their ownership of a controlling interest in the corporation to vote to themselves excessive salaries or to cause excessive salaries to be voted by persons under their control. Both the stockholders and the directors in fixing compensation of officers must act in good faith and reasonably." Fletcher, *supra*, at § 2132 (perm. ed. 1967).

The Government, in describing the decedent's alleged power to avoid dividends and yet pay himself a generous salary, describes the circumstances that have impelled equitable intervention on behalf of minority shareholders. Baker and Cary, *Cases and Materials on Corporations* (3d ed. 1959), cases collected at note 5, p. 1392. These cases surely provide little incentive for a dominant shareholder to exercise his control in the manner that the Government rather cynically characterizes as a routine incident of majority shareholder status.

"The enjoyment of a minority stock interest in a corporation is the prerogative of its owner. It may not legally be usurped by the controlling stockholder through abuse of corporate office. By application of these fundamental principles, it is clear that the decedent did not reserve the enjoyment of the stock that he gave away.

### III.

The income tax decision of *Commissioner v. Sunnen*, 333 U.S. 591 (1948), on which the Government relies, is legally and factually inapposite.

Having no support in the estate tax decisions, the Government relies heavily upon this Court's income tax decision in *Commissioner v. Sunnen*, 333 U.S. 591 (1948). Pet. Br. 12-15, 20. In so doing, the Government looks for support to the wrong body of tax law.

*Sunnen* was one of a series of decisions in which this Court developed a broad economic concept of gross income in the field of intra-family trusts and assignments. *Helvering v. Clifford*, 309 U.S. 331 (1940); *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Eubank*, 311 U.S. 122 (1940); *Harrison v. Schaffner*, 312 U.S. 579 (1941); *Commissioner v. Tower*, 327 U.S. 280 (1946); *Lusthaus v. Commissioner*, 327 U.S. 293 (1946). The income tax concept of substantial economic ownership developed in *Clifford* with respect to short-term trusts and in *Horst* with respect to transfers of negotiable bond interest coupons was extended in *Eubank* to assignments of life insurance renewal commissions, in *Schaffner* to assignment of specified amounts of trust income, and in *Tower* and *Lusthaus* to assignments of family partnership interests. *Sunnen*, citing and relying on this line of cases, 333 U.S. at 602-603, applied the same principle to an assignment of nonexclusive patent license contracts.

The *Clifford-Horst-Sunnen* doctrine of economic ownership flowered under the expansive wording of former section 22(a), now section 61 of the Internal Revenue Code. The doctrine has not penetrated the estate tax, the statutory provisions of which define in detail the property interests comprising the gross estate, leaving no room for the devel-

opment of any judicial theory of substantial economic ownership.

In *Helvering v. Safe Deposit & Trust Co.*, 316 U.S. 56 (1942), this Court limited the *Clifford* doctrine to areas where, unlike the estate tax definition of the gross estate, "the language of a statute and its legislative history do not afford more specific indications of legislative intent." 316 U.S. at 58-59, note 1. Six years later, in setting the *Church* and *Spiegel* cases for reargument (see pp. 6-7, *supra*), this Court directed counsel to discuss the following question: "9. What is the effect of the rulings of *Helvering v. Clifford* (309 U.S. 331) upon these trusts?"<sup>13</sup> 335 U.S. at 717, note 5. Significantly, this Court, after consideration of the reargument, did not rest its *Church* and *Spiegel* decisions to any extent upon the *Clifford* doctrine.<sup>14</sup>

After repeatedly declining to apply the *Clifford* doctrine in any estate tax case,<sup>15</sup> the Tax Court definitely concluded in *Estate of Alexander K. Sessoms*, 8 CCH T.C.M. 1056 (1949):

"Nor . . . can we hold this trust includible in decedent's estate as falling within the doctrine of the

13. The Government, conceding in its brief on reargument that, strictly speaking, *Clifford* had no estate tax application, asked this Court, in effect, to utilize *Clifford* as a pretext for overturning the *Northern Trust* decision.

14. The reasons (which we have already summarized) why the *Clifford* doctrine is inapplicable to the estate tax are perceptively stated in Justice Burton's dissenting opinion in the *Spiegel* case. 335 U.S. at 712-718.

15. *Estate of Henry S. Downe*, *supra*; *Estate of Samuel S. Lindsay*, 2 T.C. 174 (1943); *Estate of Edward E. Bradley*, 1 T.C. 518 (1943), *aff'd*, 140 F.2d 87 (2d Cir. 1944); *Estate of Edward Lathrop Ballard*, 47 B.T.A. 784 (1942), *aff'd*, 138 F.2d 512 (2d Cir. 1943); *Estate of Frederick S. Fish*, 45 B.T.A. 120 (1941); *Estate of Walter B. Roddenberry, Sr.*, 8 CCH T.C.M. 781 (1949); *Estate of Benjamin Paschal O'Neal*, *supra*; *Estate of Louis Stewart*, 4 CCH T.C.M. 59 (1945); *Estate of Maurice Markson*, *supra*. See also *Delaney v. Gardner*, 204 F.2d 855 (1st Cir. 1953); *Michigan Trust Co. v. Kavanagh*, 137 F.Supp. 52 (E.D. Mich. 1955).

*Clifford* case. See *Helvering v. Safe Deposit & Trust Company of Baltimore*, 316 U.S. 56, wherein the doctrine of 'substantial ownership' was rejected in the estate tax field.<sup>16</sup> 8 CCH T.C.M. at 1059.

Equally in point is the following statement of the First Circuit in *Higgins v. Commissioner*, 129 F.2d 237, 239-240 (1st Cir. 1942), *cert. denied*, 317 U.S. 658: "Helvering v. Eubank, 1940, 311 U. S. 122 . . . is another instance of a transfer where the donor must continue paying an income tax, but where the value of the property transferred will not be included in the donor's gross estate at his death."

In short, there is simply no correlation between the income and estate tax statutes in the field of incomplete transfers. See *Commissioner v. Douglass' Estate*, 143 F.2d 961, 963 (3d Cir. 1944); *Higgins v. Commissioner*, *supra*, at 239-241; *Federal Estate and Gift Taxes, A Proposal for Integration and for Correlation with the Income Tax*, United States Government Printing Office (1947) 9-11; DeWind, *The Approaching Crisis in Federal Estate and Gift Taxation*, 38 Calif. L. Rev. 79, 98-104 (1950). The legal irrelevance to the estate tax of the substantive income tax holding in *Sunnen* is so marked that that holding has never been referred to in any estate tax decision.

*Sunnen* is also factually inapposite. The taxpayer in *Sunnen*, an inventor-patentee who had entered into four nonexclusive license agreements with a controlled corporation, assigned to his wife his interest under the agreements. Either party had the right to cancel the agreements upon written notice of either six months or one year. The taxpayer retained ownership of the patents and, therefore, the right to enter into licenses with other parties, thus

16. Similarly, in *Commissioner v. Prouty*, 115 F.2d 331, 337 (1st Cir. 1940), the First Circuit rejected the Commissioner's argument that the *Clifford* doctrine should be imported into the gift tax law.

diverting royalties from his wife. All of these considerations, and not merely the taxpayer's role as controlling stockholder, caused this Court to conclude that the taxpayer had not effectively shifted the incidence of income tax liability.

#### IV.

**This case calls for application of the doctrine of *stare decisis*.**

The Government here asks this Court to take an initial step in undermining with retroactive effect the well-established rules with respect to managerial and administrative powers founded upon the 43-year old *Northern Trust* decision.

The Government beguilingly tries to make that initial step look as short and harmless as possible. In the process it attempts to distinguish case after case, saying: *Northern Trust, supra*, was decided under prior law (Pet. Br. 18-19); the investment powers in *King, supra*, were not over stocks of controlled corporations (Pet. Br. 11, note 5); powers held as trustee are different because they are governed by rules requiring impartiality (Pet. Br. 17-18 and 19-20); the income tax decision of *United States v. Gates*, 376 F.2d 65 (10th Cir. 1967), is distinguishable because the settlor in that case could not prevent sale of the trustee stock (Pet. Br. 18, note 8).

The Government's modest statement of its goals should not deceive anyone who is familiar with its often-played role in the drama of camel's nose and tent. There are many ominous signs that the Government's objectives are much more ambitious: (1) the Government's stubborn relitigation of the *Northern Trust* holding in 27 subsequent cases; (2)

the Commissioner's outstanding nonacquiescence in the Tax Court's *King* decision, involving investment and voting powers over a securities portfolio (1963-1 C.B. 5); (3) the Commissioner's publication in 1967 of a ruling that defines the taxable area to include the situation in which the settlor is a trustee (Rev. Rul. 67-54, 1967-1 C.B. 269; see comment thereon in 21 *The Tax Lawyer* 444 (1968)); (4) the continuing refusal of the Commissioner to accept the Tax Court's decision in *Hofford* that the stock transferred in trust was not includible in the gross estate (nonacquiescence on that issue, 1945 C.B. 4); and (5) the assertion of tax in the estate of which the *amici curiae* are executors, despite the fact that the decedent, as one of three trustees of whom a majority could act, was powerless to prevent sale of the stock by the other two trustees.

These indicia show that it matters not to the Government whether the deceased settlor was trustee, whether the property involved is stock in a controlled corporation or liquid securities, or whether the deceased settlor could have blocked sale of the trustee's stock. If so, what prevents taxation of outright gifts of stock? In fact, the Government has attempted to tax stock given outright during life. *Estate of George H. Burr*, 4 CCH T.C.M. 1055 (1945); *Estate of William L. Belknap*, *supra*; *George C. Doerschuck*, *supra*.

It will not suffice for the Government to answer that the gift here was not outright, that the decedent was not trustee, that the trust assets were not portfolio securities, and that the decedent could veto sale of the stock. In an area so filled with long-established precedent, this Court should not be asked to embark on a new course without some indication of where it leads. There should be some reliable answer to whether the Government's goal here and the *Northern Trust* line of decisions can harmoniously survive

and, if so, where the line can be drawn. We respectfully submit that the only place a logical line can be drawn is where the court below has drawn it.

During the 42 years that the Treasury has fruitlessly challenged the *Northern Trust* doctrine in 27 litigations, it has worked with the Congress on five legislative restructurings of section 2036 and its predecessors: In 1931,<sup>17</sup> 1932,<sup>18</sup> 1949,<sup>19</sup> 1953,<sup>20</sup> and 1954.<sup>21</sup> In this process the Treasury has counseled the Congress in overturning nine decisions of this Court relating to what is now section 2036.<sup>22</sup> Whatever discontent the Treasury had with the *Northern Trust* holding could have been taken up with the Congress on any of those or other occasions. Having failed to utilize those opportunities, the Treasury should be foreclosed from seeking a remedy in this Court at this late date.

For the 55 years that Americans have lived and died under the regime of the Federal estate tax, apparently no trust has been taxed—certainly none willing to litigate has been taxed—because of reserved managerial or administrative powers. The Court is being asked here to subject to tax an indeterminate—perhaps broad—category of trusts that have for decades been regarded as nontaxable. The

17. Joint Resolution 529 of March 3, 1931.

18. Revenue Act of 1932, section 803(a).

19. Technical Changes Act of 1949, sections 7 and 8.

20. Technical Changes Act of 1953, section 207.

21. Internal Revenue Code of 1954, section 2036.

22. The 1931 and 1932 legislation overturned *May v. Heiner*, 281 U.S. 238 (1930), *Burnet v. Northern Trust Co.*, 283 U.S. 282 (1931), *Morsman v. Burnet*, 283 U.S. 783 (1931), and *McCormick v. Burnet*, *supra*. The 1949 and 1953 legislation overturned *Fidelity-Philadelphia Trust Co. v. Rothensies*, 324 U.S. 108 (1945), *Commissioner v. Estate of Field*, 324 U.S. 113 (1945), *Goldstone v. United States*, 325 U.S. 687 (1945), and *Estate of Spiegel v. Commissioner*, *supra*. The 1949 and 1954 legislation overturned *Commissioner v. Estate of Church*, *supra*.

Federal estate tax is a capital levy with rates ranging upward to 77 percent. The unexpected aggregation of an *inter vivos* trust with the testamentary estate can wreak havoc with estate planning and even leave the testamentary beneficiaries penniless. If the long-established *Northern Trust* holding is to be changed, this responsibility should be left to Congress, which can give notice of the proposed change, hold hearings, make the change prospective only, create grace periods for relinquishment of taxable powers, and provide other relief. Under any reasonable view of the situation, the Government is asking the wrong body to make the wrong decision at the wrong time.

The Government has twice persuaded this Court to disregard *stare decisis* in construing what is now section 2036 of the Internal Revenue Code. The Government here invites the court to embark on a third such departure. Review of these other two instances and the Congressional overriding that followed further indicates the undesirability of the Government's present proposal. (1) In 1940, in *Helvering v. Hallock*, 309 U. S. 106, this Court, at the urging of the Government, expressly overruled its 1935 decisions in *Helvering v. St. Louis Union Trust Co.*, 296 U. S. 39, and *Becker v. St. Louis Union Trust Co.*, 296 U. S. 48.<sup>23</sup> Heeding criticism of the Court's action, Congress amended section 811(c) of the Internal Revenue Code of 1939 (now section

23. The trusts in those three cases all provided for reversion of the trust properties to the settlors if they should outlive the beneficiaries. Having decided in the two *St. Louis Union Trust* cases that passage of title to the trust properties was enough to render the predecessor of section 2036 inapplicable, the court shifted to the opposite view in *Hallock*. Over the dissenting opinion of Justice Roberts in support of *stare decisis*, this Court introduced in *Hallock* the first of a line of decisions that based the estate tax on the retention of more and more remote reversionary interests. *Fidelity-Philadelphia Trust*, *supra*; *Field*, *supra*; *Goldstone*, *supra*; and, finally, the controversial "gossamer thread" arising by operation of law in *Spiegel*, *supra*, 335 U. S. at 667-674, 703-708, 718-735.

2036 of the Internal Revenue Code of 1954) to erode the decisions and to authorize the filing of claims for refund without regard to the doctrine of *res judicata*.<sup>24</sup> (2) In 1949 in *Church, supra*, this Court, upon the request of the Government following the setting of the case for reargument, explicitly overruled its 18-year old decision in *May v. Heiner, supra*, three 1931 *per curiam* decisions that followed and extended the rule of the *May* case,<sup>25</sup> and its 1938 decision in *Hassett v. Welch*, 303 U. S. 303.<sup>26</sup> In the face of spirited dissents advocating the wisdom of *stare decisis*, this Court overturned 18-years of estate tax history. Heeding the resulting criticism, Congress restored the rule that *Church* had overturned.<sup>27</sup>

Even if the question presented here were one of first impression, the rule of law the Government seeks to establish would represent highly questionable tax policy. When the question is examined in the light of the long judicial and legislative history, the Government's request, if it should be made at all, should be made to Congress. From the standpoints of both history and logic, the Government's plea to this Court should fail.

24. Public Law 378, 81st Cong. (Technical Changes Act of 1949), section 7; Int. Rev. Code of 1954, section 2037(a).

25. *Burnet v. Northern Trust Co., supra*; *Morsman v. Burnet, supra*; *McCormick v. Burnet, supra*.

26. In *May* and the three *per curiam* decisions, this Court held that retention of a life estate in transferred property did not attract the estate tax if transfer of title was effective. After Congress had enacted remedial legislation on the day following the three *per curiam* decisions, this Court decided in *Welch* that the remedial legislation applied prospectively only.

27. Public Law 378, 81st Cong. (Technical Changes Act of 1949), sections 7 and 8; Public Law 287, 83d Cong. (Technical Changes Act of 1953), section 207.

## CONCLUSION

The decision below should be affirmed.

Respectfully submitted,

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